



UNIVERSITY OF
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FACULTY OF LAW



CONTESTED CORPORATE TRANSACTIONS

VOLUME I

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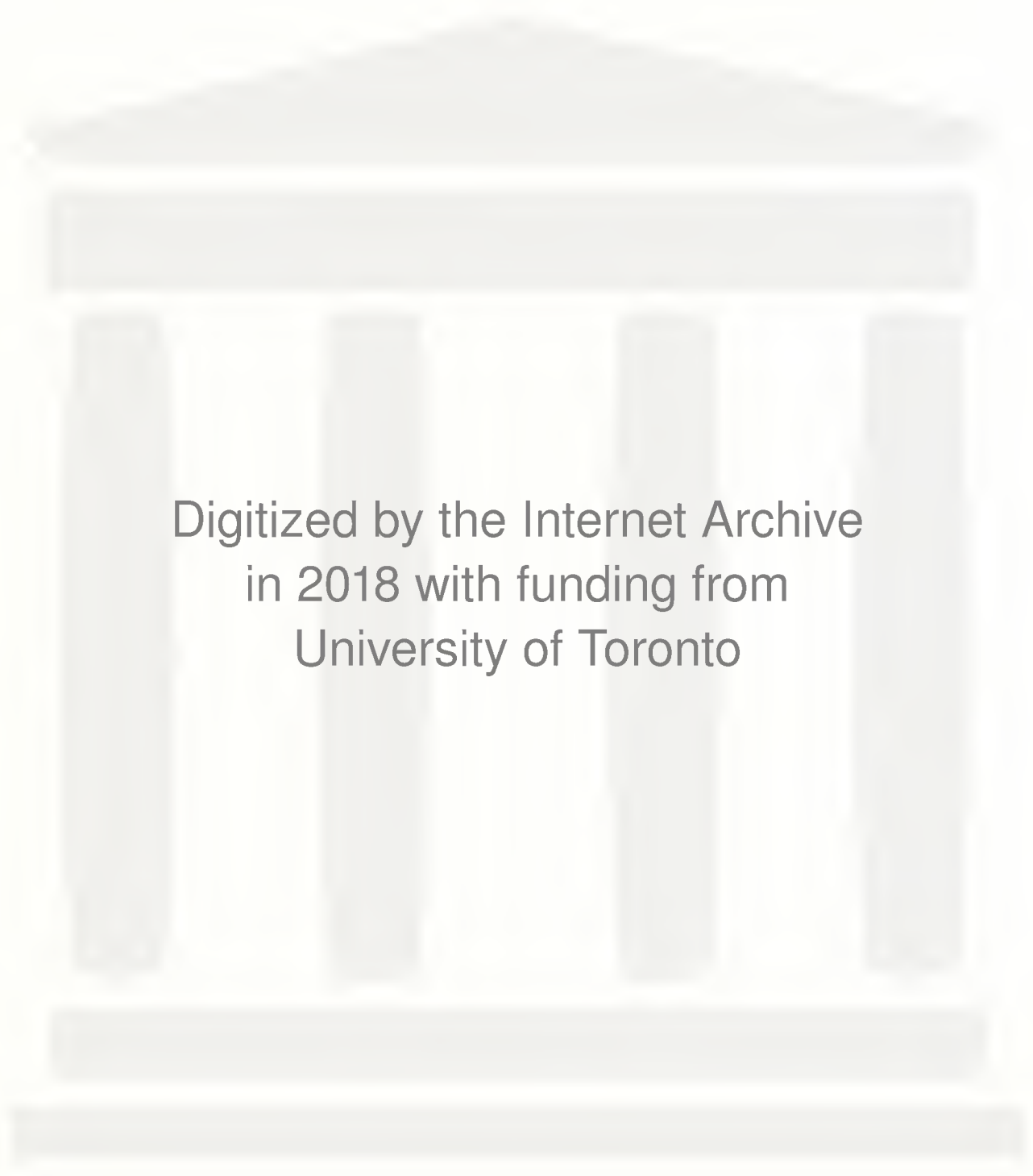
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TABLE OF CONTENTS

VOLUME I

1. Glossary of Some Commonly Used Deal Terms
2. “Background Notes on Equity Acquisition Structures”, prepared by Pat Koval
3. Re Financial Models Co. (2005), 28 O.S.C.B. 2184
4. Re Sears Canada Inc. (2006), 22 B.L.R. (4th) 267 (O.S.C.)
5. Re Sears Canada Inc. (2006), 84 O.R. (3d) 61 (Ont. S.C.J. (Div. Ct.))
6. “Background Notes on How Securities are Held” prepared by Pat Koval (Optional reading)
7. Statutory sections regarding compulsory acquisitions, going private transactions and squeeze-out transactions: *Business Corporations Act* (Ontario): Part XV (compulsory acquisitions and going private transactions); section 185 (dissent and appraisal rights)
8. Multilateral Instrument 62-104 — *Take-Over Bids and Issuer Bids*
9. Advertisement by Xstrata Canada Inc. to Holders of Common Shares of Falconbridge Limited
10. Offer by Saskatchewan Wheat Pool Inc. to Purchase All of the Outstanding Securities of Agricore United, dated November 24, 2006.
11. Agricore United Directors’ Circular dated December 12, 2006 Recommending Rejection of the Offer by Saskatchewan Wheat Pool Inc.
12. Statutory sections regarding requests for shareholders’ lists: sections 146, 146.1 and 147 of the *Business Corporations Act* (Ontario)
13. CSX Corporation v. The Children’s Investment Fund Management (UK) LLP, 08 Civ. 2764 (LAK) (S.D.N.Y. June 11, 2008)
14. Re Sterling Centrecorp Inc., (2007), 30 O.S.C.B. 6683 and Re Sterling Centrecorp Inc., [2007] O.J. No. 3072 (Ont. S.C.J. [Commercial List])
15. Bingham v. Ashton Mining of Canada Inc., [2007] B.C.J. No. 410 (B.C.S.C.)
16. Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946 (Del. Sup. Ct. 1985)
17. Unitrin, Inc. v. American General Corp., 651 A. 2d 1361 (Del. Sup. Ct. 1995)

18. Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A. 2d 173 (Del. Sup. Ct. 1986)
19. In Re Toys “R” Us, Inc., Shareholder Litigation, 877 A.2d 975, 2005 Del. Ch. LEXIS 90 (Del. Ch.)
20. Smith v. Van Gorkom, 488 A. 2d 858 (Del. Sup. Ct. 1985)
21. In Re Cox Communications, Inc. Shareholders Litigation, 2005 Del. Ch. LEXIS 79 (Del. Ch.)
22. In Re Tele-Communications, Inc. Shareholders Litigation, Civil Action No. 16470 (Del. Ch. December 21, 2005)
23. C.W. Shareholdings Inc. v. WIC Western International Communications Ltd. (1998), 39 O.R. (3rd) 755 (Ont. Gen. Div. [Commercial List])
24. Pente Investment Management Ltd. v. Schneider Corp. (sub nom. Maple Leaf Foods Inc. v. Schneider Corp.) (1998), 42 O.R. (3d) 177 (C.A.)
25. Peoples Department Stores Inc., (Trustee of) v. Wise, [2004] S.C.J. No.64 (S.C.C.)
26. Turner, James E. A., “A Guide for Directors: How Directors Can Navigate the Potential Problems of M&As ,” (Ivey Business Journal, July/August 2000)



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GLOSSARY OF SOME COMMONLY USED DEAL TERMS

“Auction”

- Process by which a target issuer typically solicits bids from prospective buyers, generally with the assistance of the target’s financial adviser.

“Break-up Fee”

- A fixed fee required to be paid to a White Knight or friendly bidder by a target issuer in case the friendly bid does not succeed for any reason (see also “topping fee”).

“Crown Jewels”

- Key assets having a high cash value that can be sold (and the cash paid out by dividend to shareholders) and consequently render a target issuer less attractive.

“Delaware Merger”

- A term used by Canadians to refer to an acquisition transaction in which, following a bid, or instead of a bid, the target corporation is amalgamated with a subsidiary of the acquiror.

“Golden Parachute”

- Substantial termination payment to an officer of the target issuer to ease the pain of separation and which will have the additional effect of increasing the acquisition cost to the bidder.

“Go Shop” Clause

- A provision typically found in a support agreement which provides the target with a limited period of time to canvass the market for other purchasers.

“Greenmail”

- A term used in the U.S. to refer to a payment by an issuer of a specifically targeted premium to a potential bidder to repurchase a block of shares of the issuer held by it (not permitted in Canada, see *Ontario Securities Act* s. 89 and 93(3)).

“Hedge Fund”

- Hedge funds are private investment funds open to a limited range of professional or wealthy investors. In many jurisdictions, this provides them with an exemption from regulations governing short selling, derivative contracts, leverage, fee structures and the liquidity of investments in the fund. Hedge funds tend to invest in a broad range of investments, from shares, debt and commodities to works of art. Hedge funds often seek to offset potential losses in the principal markets they invest in by hedging their investments using a variety of methods such as short selling, though the term "hedge fund" has also come to be applied to many funds that do not actually hedge their investments.

“Lock-up Agreement”

- An agreement entered into between a shareholder of a target and a prospective bidder, in which the shareholder agrees to tender, sometimes on an irrevocable basis, to a take-over bid made by the bidder on the terms and conditions described in the agreement.

“MAC Condition”

- A “material adverse change” condition referring to the business, affairs and financial condition of the target issuer and typically included as a condition to the obligations of a bidder in a take-over bid.

“Merger”

- In Canada, a general term used to describe any transaction or method by which two or more businesses are combined; in the U.S., a merger is a statutory procedure by which two or more predecessor corporations combine to form a single corporation with the effect of preserving the identity of one of the predecessors and extinguishing the identity of the other (there is no parallel Canadian statutory concept).

“No Shop” Clause

- An undertaking by a target issuer not to actively seek (or “shop for”) higher bidders.

“Poison Pill”

- Generally, attributes of securities of a target issuer or existing contractual arrangements of a target issuer that make it significantly less attractive to a bidder.

“Poison Pill Plan” or “Shareholder Rights Plan”

- A typical defensive measure intended to protect shareholders against unfair or coercive take-over bid tactics by hostile bidders; typically, under the plan, shareholders receive “rights” to acquire additional shares at an exercise price considerably in excess of the price at which the shares then trade in the market (i.e. “out of the money”); upon the occurrence of a Triggering Event, the plan will provide that if an acquiring person has crossed the designated sharehold of share ownership, each right will thereafter entitle all holders, other than the acquiring person, to purchase that number of shares having an aggregate market value equal to twice the exercise price of the rights (while any rights held or acquired by the acquiring person will be null and void and cannot be exercised); owing to the massive dilution that the occurrence of the “flip in event”, described above, would cause, bidders are typically not prepared to acquire shares and trigger the plan.

“Private Equity Fund”

- A private equity fund is a pooled investment vehicle used for making investments in various equity (and to a lesser extent debt) securities in operating companies. Among other activities, private equity funds may make venture capital or growth capital investments in private companies or pursue leveraged buyouts of public companies with the intention of taking them private. A private equity fund is raised and managed by investment professionals of a specific private equity firm (the general partner and investment advisor of the fund). Typically, a single private equity firm will manage a series of distinct private equity funds and will attempt to raise a new fund every 3 to 5 years as the previous fund is fully invested.

“Scorched Earth”

- A term frequently used in the U.S. to refer to the sale of the underlying assets of a potential target corporation to realize their value for the shareholders and so pre-empt any take-over bid.

“Shareholder Rights Plan”

- See “Poison Pill”.

“Shark Repellant”

- Provisions of a potential target issuer’s constating documents (i.e. by-laws) or of contracts that render the target less desirable to a potential bidder that “smells blood”, e.g. a staggered board, supermajority vote required to approve certain corporate action.

“Sovereign Wealth Fund”

- Sovereign wealth funds are state-owned investment funds composed of financial assets such as equity and debt securities, property, precious metals or other financial instruments. They are typically funded by foreign exchange assets or the proceeds of non-renewable natural resources such as oil. These assets are managed separately from official reserves. Some sovereign wealth funds are held solely by central banks, who accumulate the funds in the course of their management of a nation’s banking system. Sovereign wealth fund managers typically have a higher risk tolerance, longer investment horizon and higher expected return than traditional official reserve managers. Sovereign wealth funds became prominent as a result of their investments in several Wall Street financial firms including Citigroup, Morgan Stanley, and Merrill Lynch in connection with the subprime mortgage crisis.

“Stalking Horse”

- A White Knight, to ensure that it is not being put to the expense of evaluating and planning a bid or merger only to help force up the price of the target corporation’s shares, frequently will insist on No Shop clauses and a Break Fee or Topping Fee.

“Standstill Agreement”

- An agreement pursuant to which a potential bidder agrees not to increase its holdings of target issuer’s shares beyond a specified level, except in case of a third party bid, thus discouraging any other bid.

“Street Sweep”

- A term used in the U.S. to refer to the purchase of large quantities of a target corporation’s shares from arbitrageurs and speculators, usually after withdrawal of a take-over bid. (Such purchases are constrained in Canada: see, e.g., *Ontario Securities Act* s. 94(6) which suspends a bidder’s right to make such purchases for a period of 20 business days following the expiry of the bid).

“Support Agreement” or “Pre-Acquisition Agreement”

- An agreement entered into between a threatened or target issuer and a White Knight pursuant to which the board of directors of the issuer agrees to support the acquisition of the issuer by the White Knight, typically by means of a take-over bid or other merger transaction, and the board of directors agrees to recommend the transaction to shareholders of the issuer.

“Topping Fee”

- A fixed fee required to be paid to a White Knight or friendly bidder by a target issuer in the event that the friendly bid does not proceed because another bidder makes a higher bid (see also “break-up fee”).

“Triggering Event”

- A threshold limit, e.g. acquisition by bidder or potential bidder of 20% of a target corporation’s voting shares, which when reached, triggers the operation of a Poison Pill Plan or some other conversion privilege.

“White Knight”

- An issuer that enters into a Support Agreement with a threatened target issuer to insulate the target from a threatened or actual take-over bid.

“White Squire”

- A friendly person that holds a substantial block of a target issuer’s shares under a Standstill Agreement which limits that person’s right to acquire more shares or, in some cases, to vote shares it holds.

BACKGROUND NOTES ON EQUITY ACQUISITION TRANSACTION STRUCTURES

In practice, most acquirors want to acquire ALL of the equity shares of a target company. This will give the acquiror (“Acquiror”) the greatest flexibility – without the need to deal with minority shareholders who would otherwise retain rights to approve fundamental changes and certain types of transactions under applicable corporate and securities laws, rights to receive information under applicable securities laws and other important rights (i.e. through the oppression and other remedies under applicable law). There are four principal methods by which an Acquiror can set out to acquire 100% of the equity of a publicly-traded company (“Target”):

- (a) **Take-Over Bid** - a take-over bid made by the Acquiror to purchase all of the shares held by the shareholders of Target followed by, if 90% or more of the shares of Target subject to the bid held by the public shareholders are tendered under the bid, the compulsory acquisition pursuant to applicable corporate law of all shares not tendered (e.g., section 188 of the *Business Corporations Act* (Ontario) (the “OBCA”) and section 206 of the *Canada Business Corporations Act* (Canada) (“CBCA”) provides that if, within the 120 days after the date of a take-over bid, the bid is accepted by the holders of not less than 90% of the securities of any class of securities to which the bid relates, other than securities held at the date of the bid by or on behalf of the offeror, or an affiliate or associate of the offeror, the offeror is entitled to compulsorily acquire the securities of the non-tendering dissenting minority);
- (b) **Plan of Arrangement** - a plan of arrangement pursuant to applicable corporate law (e.g., section 182 of the OBCA; section 192 of the CBCA), pursuant to which all holders of shares of Target (other than the Acquiror) transfer their shares to the Acquiror in exchange for the consideration offered;
- (c) **Amalgamation** - an amalgamation of Target and the Acquiror or a wholly-owned subsidiary of the Acquiror pursuant to applicable corporate law (e.g., sections 174, 175, 176 and 177 of the OBCA; sections 181, 182, 183 and 184 of the CBCA) on a basis whereby the Acquiror would receive all of the common shares of the amalgamated corporation (“Target Amalco”) and all holders of shares (other than the Acquiror) would receive either redeemable preference shares of Target Amalco (“Target Amalco Preference Shares”), which would be redeemed for cash immediately following the amalgamation, or securities of the Acquiror; and
- (d) **Take-Over Bid Followed by Amalgamation or Arrangement** - this form of transaction is a combination of the transactions described above in circumstances where the compulsory acquisition provisions under applicable corporate law are NOT available because less than 90% of the shares subject to the bid held by the public were tendered. In such circumstances, a second-stage amalgamation or arrangement is used to “squeeze-out” the remaining shares not tendered to the first stage take-over bid. (See, e.g., the definition of a “squeeze-out transaction” in section 2 of the CBCA).

Take-Over Bid

A take-over bid by an Acquiror is the only type of transaction which is available for a hostile or non-negotiated, unsolicited transaction to acquire control of Target. The Acquiror can announce a take-over bid without the knowledge or concurrence of Target and its board of directors and put Target “into play” on a hostile, unsolicited basis. By doing so, the Acquiror must recognize that Target is likely to react in a hostile manner to the unsolicited offer and explore alternatives to the Acquiror’s offer on a basis that may make it difficult for the Acquiror to win. This course will deal in detail with all aspects of take-over bids, including the process by which “hostile” bids can eventually become “friendly”.

Plan of Arrangement

An arrangement is a court-approved corporate transaction undertaken in accordance with specific statutory requirements (eg. section 182 of the OBCA). Pursuant to applicable corporate law, a corporation may enter an arrangement for essentially any purpose, including under section 182 of the OBCA, any of the following purposes:

- (a) a reorganization of the shares of any class or series of the corporation or of the stated capital of any such class or series;
- (b) the addition to or removal from the articles of the corporation of any provision that is permitted by the OBCA to be, or that is, set out in the articles or the change of any such provision;
- (c) an amalgamation of the corporation with another corporation;
- (d) an amalgamation of a body corporate with a corporation that results in an amalgamated corporation subject to the OBCA;
- (e) a transfer of all or substantially all the property of the corporation to another body corporate in exchange for securities, money or other property of the body corporate; and
- (f) an exchange of securities of the corporation held by security holders for other securities, money or other property of the corporation or securities, money or other property of another body corporate that is not a take-over bid as defined in the *Securities Act* (Ontario). (emphasis added)

A “going private” (or privatization) transaction may be effected through a plan of arrangement in order to avoid having to achieve the high 90% acceptance level by the public shareholders of Target required for compulsory acquisition. However, owing to the fact that a Target must initiate and carry out the steps to achieve an arrangement, including in particular, seeking court approval, a plan of arrangement can only be accomplished in a friendly transaction negotiated with the board of directors (or special committee) of Target.

A plan of arrangement provides substantially more flexibility than does an amalgamation and can enable Target and the Acquiror to implement a series of steps which

occur in a specified order at the time the arrangement becomes effective. This may assist in implementing tax strategies.

In addition, unlike a take-over bid, a plan of arrangement can be used to offer differing consideration to different groups. For example, holders of Target shares, other than members of management, could exchange such shares for redeemable shares of Target, which then could be redeemed as part of the arrangement. As well, as part of the arrangement, the share capital of Target could be restructured in accordance with any agreements between management and the third party Acquiror to accommodate a leveraged buy-out with management participation. As yet another example, a plan of arrangement can be used by a company to convert itself from a public company to a publicly-traded income trust.

Currently, an arrangement is the preferred transaction structure for a share exchange acquisition of a Canadian public company by a foreign public Acquiror in consideration for exchangeable shares issued by a Canadian issuer that are exchangeable into shares of the foreign public Acquiror. The exchangeable shares would qualify as Canadian property and would allow for a tax-free rollover under Canadian tax rules. Although it would be possible to structure a friendly exchangeable share transaction as a share exchange take-over bid, the necessary complexity of the transaction leads more logically to the arrangement structure. An exchangeable share transaction would be difficult to achieve as a hostile take-over bid.

An arrangement requires court approval, which thus provides a forum for constituencies to attack or challenge the transaction (such as preferred shareholders, dissenting shareholders or debtholders). The Court's role is to ensure that the transaction is both procedurally fair (i.e., the method of undertaking the transaction, including the voting thresholds for approval from shareholders, is appropriate) and substantively fair. Counsel for the company proposing the arrangement will seek to obtain an interim order at an initial interim hearing. This interim court order will set out: the provisions for the calling of the shareholders meeting and meetings of any other affected interested parties (i.e. debtholders), documentation to be sent to shareholders and affected interested parties, and the approvals (with requisite voting thresholds) required to be obtained from each. In determining and proposing voting thresholds, the Company must also comply with applicable corporate laws and OSC Rule 61-501 if the transaction constitutes a "business combination" (see also "going private transaction", section 190 of the OBCA or section 193 of the CBCA) or "related party transaction".

The interim order is generally obtained immediately prior to finalizing the information circular to be forwarded to shareholders in connection with the shareholders' meeting to be held to approve the plan of arrangement. A final order of the court must be obtained following the shareholders' meeting and prior to filing the articles of arrangement which give effect to the plan of arrangement. In determining whether to grant the final order, the court generally considers whether the plan of arrangement is fair and reasonable to all shareholders, including the minority shareholders. The approval by the requisite level of minority shareholders (if required) is generally viewed as prima facie evidence of such fairness. Because of the Court's scrutiny as to the fairness of the transaction, participants in the completed arrangement transactions generally draw considerable comfort from the fact that the transaction is unlikely to be subject to subsequent court challenge.

Amalgamation

An amalgamation is the legal fusion of two predecessor corporations into one “amalgamated” corporation. Under applicable Canadian corporate law, both amalgamating companies must be governed by the same corporate statute; hence if a CBCA and an OBCA company wish to amalgamate, one must “continue” into the jurisdiction of the other.

An acquisition may be effected by a one-step amalgamation in order to avoid having to achieve the high 90% acceptance level of the public shareholders of Target required for compulsory acquisition. Such a transaction might be typically structured as follows:

- (i) the Acquiror will establish a subsidiary, Acquireco, for the sole purpose of amalgamating with Target;
- (ii) Acquireco and Target will enter into an amalgamation agreement pursuant to which Acquireco and Target are amalgamated to continue as Amalco; and
- (iii) a special shareholders’ meeting of Target will be called in order to approve a special resolution giving effect to the amalgamation agreement, which requires the affirmative vote of at least 2/3 of the shares held by the holders of each class of shares of Target who are present, in person or proxy, and voting at the meeting. For this purpose, shareholders include those not normally permitted to vote. Under certain circumstances, shareholders may be entitled to a separate class or series (i.e. see section 176 of the OBCA). The amalgamation could only proceed if it were approved - by a 2/3 majority - in each of the separate votes.

Additional minority approval may be required under OSC Rule 61-501 and/or applicable corporate law if the transaction is considered to be a “business combination” or “related party transaction”.

If the transaction is a true merger, Acquireco and Target could amalgamate under applicable corporate law and former shareholders of Acquireco and Target could receive shares of Amalco based on a negotiated exchange ratio. Alternatively, if the transaction is an acquisition, pursuant to the amalgamation agreement, shareholders of Target will receive redeemable preferred shares of Amalco which will be redeemed for cash (or exchanged for shares of the Acquiror, or some combination of cash or shares) immediately following the amalgamation and shareholders of Acquireco will receive common shares of Amalco. Following the amalgamation, the Acquiror, being the sole shareholder of Acquireco, will be the sole shareholder of Amalco.

One variation on this transaction would involve Acquireco being wholly owned by Holdco and Holdco in turn being owned by the Acquiror. The amalgamation agreement could then permit shareholders of Target to elect to convert their shares of Target into either class A preferred shares of Amalco which would be redeemed for cash immediately following the amalgamation, or Class B preferred shares of Amalco which would be purchased for cash by Holdco immediately following the amalgamation, thus entitling shareholders to elect to receive a

deemed dividend or capital gains treatment for tax purposes. Following the amalgamation, Holdco and Amalco could amalgamate if the Acquiror wished to hold their interest in Amalco directly or, alternatively, Amalco could be wound up into Holdco.

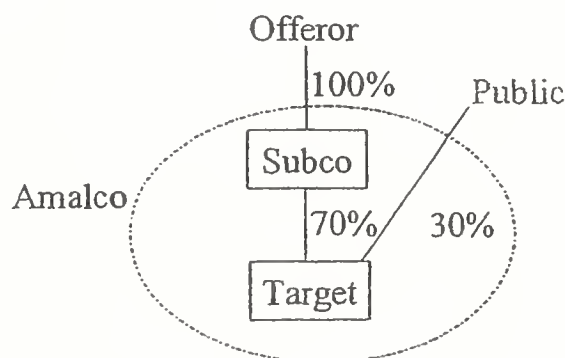
Take-Over-Bid Followed by Amalgamation or Arrangement (“Going Private Transactions” or “Squeeze-Outs”)

A privatization may be effected by a “multiple-stage” transaction pursuant to which the Acquiror initially makes a take-over bid and, if 90% or more of the shares not held by the Acquiror (or affiliate or associates of Acquiror) (that is, the minority shareholders) are tendered under the take-over bid, Acquiror then uses the compulsory acquisition provisions of applicable corporate law to acquire the remaining shares. (These provisions, (section 188 of the OBCA and section 206 of the CBCA) set out a detailed procedure, including strict timelines, which must be followed by the Acquiror.)

If, as is more commonly the case, however, less than 90% of the shares are tendered to the take-over bid, then a second stage transaction will be implemented, such as an amalgamation or arrangement of Target on a basis whereby Acquiror would acquire all of the remaining shares for at least the consideration offered in the first step take-over bid.

A sample second-stage “squeeze-out” transaction is illustrated as follows:

- Assume that Acquiror did not own any shares of Target prior to the take-over bid.
- 70% of the shares of Target are then acquired by Acquiror pursuant to the take-over bid. Acquiror rolls the shares acquired pursuant to the take-over bid into a wholly-owned subsidiary, Subco. Subco and Target are incorporated under the OBCA.



In this process, Subco and Target will be amalgamated to form Amalco and, on the amalgamation, Acquiror will receive all of the equity shares of Amalco, the public will receive redeemable preference shares of Amalco which will immediately be redeemed for cash, and the 70% inter-company shareholding will be cancelled.

Alternatively, on the amalgamation, the public shareholders might receive equity shares of Acquiror (which might be a listed public company).

Structural Issues under Corporate Legislation Relating to Arrangements and Amalgamations

Director and Shareholder Approval Requirements

Board of directors approval is required for all corporations involved. Requirements for shareholder approval in the context of an arrangement or amalgamation arise from two sources — (i) corporate legislation and related case law, and (ii) rules of securities commissions, including, in particular, OSC Rule 61-501. The issues which must be addressed are: (i) if the transaction is an arrangement, whether shareholder approval is required for the proposed transaction, (ii) the level of shareholder approval which must be obtained, (iii) the classes or series of securities entitled to vote, including whether any separate class or series votes are required, and (iv) whether “majority of the minority” approval is required.

Voting Requirements

Under applicable corporate law, certain transactions, referred to as “fundamental changes”, generally require approval of the shareholders of a corporation by special resolution (a resolution submitted to a special meeting of shareholders duly called for the purpose of considering the resolution and passed, with or without amendment, by at least two-thirds of the votes cast) including:

- (a) plan of arrangement (OBCA, section 182, but see below);
- (b) articles of amendment (OBCA section 168(5)); and
- (c) amalgamation (OBCA section 176(4)).

The CBCA does not specify any particular shareholder approval for a plan of arrangement but provides (section 192(4)(c)) that the court may require the corporation involved to call, hold and conduct a meeting of holders of securities or options or rights to acquire securities in such manner as the court directs. If the transaction, however, constitutes a “squeeze-out transaction”, section 194 of the CBCA requires that, in addition to any other approval of shareholders required by or under the CBCA or the articles of the corporation, the transaction must be approved by a “majority of the minority”, i.e. an ordinary resolution of the holders of each class of shares that are affected by the transaction, voting separately, whether or not the shares otherwise carry the right to vote (with the exception of shares held by affiliates of the corporation and holders of shares that would, following the “squeeze-out transaction”, be entitled to consideration of greater value or to superior rights or privileges than those available to other holders of shares of the same class). As well, section 193 of the CBCA provides that if the transaction constitutes a “going private transaction”, it may not carry out that transaction, if there are provincial securities laws applicable to such transactions, unless the corporation complies with those laws. This, in turn, requires consideration of the various approval requirements of OSC Rule 61-501.

Under the OBCA, the court has the discretion to override the general shareholder approval rights in section 182(3). Generally, a court considering a plan of arrangement would be expected to impose the same voting requirements in respect of a plan of arrangement (both in terms of the requirement for shareholder approval and the classes of securities permitted to vote) as would apply to other “fundamental changes”, such as amendment of articles or long-form amalgamation. As well, section 190 of the OBCA provides that if the transaction constitutes a going private transaction, majority of the minority approval is required in accordance with that provision. The OBCA permits a court (section 182(5)(b)) to order additional meetings of holders of securities or warrants (which include options and rights to acquire securities) of the corporation or to order a separate vote of all or any particular group of holders of any securities or warrants of the corporation in such manner as the court directs. Thus, the court under both the OBCA and the CBCA plan of arrangement provisions has a broad jurisdiction to direct the manner in which the meetings of holders of securities of a corporation will be conducted for a plan of arrangement.

Separate class or series votes will also be required if an amalgamation proposal effects a change which, if proposed by way of an amendment to the articles, would require a separate class or series vote (OBCA section 176(3), CBCA section 183(4)); similar considerations also apply under the OBCA in respect of arrangements (OBCA section 182(4)).

As a practical matter, if the arrangement or amalgamation is taking place after completion of a take-over bid, then, if Acquiror has acquired at least two-thirds of each class of shares of Target entitled to vote, Acquiror will have sufficient shares to approve any “squeeze-out” as a corporate matter. This conclusion could be subject to a court challenge on the basis that such a court action is oppressive or unfairly prejudicial to the minority shareholders. Indeed, in the late 1970’s, there were a number of cases in which injunctions were obtained on this basis. More recently, however, with the imposition of Ontario Securities Commission Rule 61-501, substantive and procedural fairness guidelines have been imposed in connection with voting requirements and, as a result, it is generally considered that the likelihood of a challenge under corporate law terms would be unlikely in any situation in which OSC Rule 61-501 has been complied with.

Majority of the Minority Approval

“Majority of the minority” usually refers to the approval of a particular transaction (in addition to any other corporate approvals) by a majority of the votes cast at a shareholders’ meeting called to consider the transaction other than votes attaching to securities held by affiliates of the issuer or securities the beneficial owners of which, alone or in concert with others, effectively control the issuer or are proposing the transaction or receiving a special benefit from the transaction.

Majority of the minority approval may be imposed under OSC Rule 61-501 or in connection with a plan of arrangement by order of the court or may be required under general corporate law principles as espoused in the *Re Hellenic Trusts* line of cases. See *Re Hellenic & General Trust Ltd.*, [1975] 3 All E.R. 382. Where shareholder approval is required, majority of the minority approval should be seriously considered where the transaction results in a shareholder or a group of shareholders being treated or affected differently than shareholders

generally, or results in benefits accruing to a shareholder or a group of shareholders different than or which are not available to shareholders generally on a *pro rata* basis so that one shareholder or group of shareholders can be said to have a different interest in the transaction than shareholders generally on a *pro rata* basis.

Majority of the minority approval will be required under OSC Rule 61-501 where the reorganization involves a “business combination” or, in certain circumstances, a “related party transaction”.

Dissent and Appraisal Rights

Corporate legislation provides a procedure for shareholders to dissent from certain special resolutions and to require the corporation to pay to the shareholder the fair value of the shares held by that holder. The provisions of corporate legislation providing for such dissent rights provide for a detailed procedure which must be followed for a shareholder to exercise such rights. In general terms, if the corporation and the shareholder are unable to agree on the fair value of the shares through the prescribed procedures, then the corporation or the dissenting shareholder may apply to the court to fix the fair value of the shares.

Under section 185 of the OBCA and section 190 of the CBCA, shareholders are entitled to dissent and the right to be paid fair value for their shares (the appraisal remedy) if a corporation resolves to amalgamate with another corporation. Under an arrangement, dissent and appraisal rights are typically ordered by the court under the interim order to be granted to dissenting shareholders.

HOW SECURITIES ARE HELD AND HOW THEY TRADE

Prepared by Patricia A. Koval

A. Background

1. Investors are typically described as either "retail investors" or "institutional investors". A retail investor is usually an individual, while the category of "institutional investor" typically includes pension funds, mutual funds, professional investment managers, banks, and insurance companies.
2. As you will know from your course in Securities Regulation, an investor residing in a jurisdiction of Canada may only "trade" i.e. buy or sell securities, through a dealer or broker who is registered as a "dealer" under the securities legislation of the jurisdiction in which the investor resides. There are certain exemptions from this requirement in prescribed circumstances.
3. A Canadian corporation is typically required to issue securities in registered form and to maintain a security register that complies with the legislation under which the corporation is formed. Section 50 of the Canada Business Corporations Act, for example, requires a corporation to maintain a security register in which it records the securities issued by it in registered form, showing with respect to each class or series of securities, the names, alphabetically arranged and the latest known address of each person who is or has been a security holder, the number of securities held by each security holder, and the date and the particulars of the issue and transfer of each security. Section 50(2) permits a corporation to appoint an agent to maintain a central security register and branch security register.

Companies which issue securities to the public (known as "public companies," "publicly traded companies," "reporting issuers" or "distributing companies,") typically hire a specialist firm, known as a "registrar and transfer agent" for this purpose. In Canada, there are only several major firms in this business, and they are typically trust companies.

Corporations legislation in Canada generally provides that a corporation, subject to certain exceptions, is entitled to treat the registered owner of a security as the person exclusively entitled to vote, to receive notices, to receive any interest, dividend or other payments in respect of the security, and otherwise to exercise all the rights and powers of an owner of the security. As we will see later in the course, securities legislation now supplements the requirements of corporation law in a very meaningful way.

B. Retail Investors

1. Retail investors typically buy shares for themselves and/or for their registered retirement savings plans (or registered education savings plans or other approved tax deferral plans). Registered retirement savings plans (or "RRSP's") are legally separate entities from the individual who creates them. As a technical matter, an RRSP account must be

constituted as a trust, with a qualified trust company which acts as the trustee. In some cases, investment discretion is given to the trustee while in another case, typically known as a "self-directed RRSP", the person who creates the RRSP directs how the investments of the RRSP are to be made.

2. Over the past 20 years, a significant evolution has occurred in the way in which individuals hold shares of public companies. As indicated above, a retail investor must generally always use a registered dealer to buy and sell securities on his or her behalf; today, the broker or dealer normally also performs the function of holding the securities on behalf of the investor, in an account established for the client by the broker or dealer. This is also referred to as holding securities in "street name".
3. The most significant development in the process of securities trading over the past 20 years has been the development of so-called "book entry only" or "electronic trading". In Canada, that process has been facilitated through the establishment of CDS Clearing and Depository Services Inc., or "CDS", as it is known. CDS is a depository, in which persons who have contracted to be "participants" are entitled to physically or electronically deposit or withdraw their securities, and to benefit from the electronic clearing and settlement services which CDS provides. Registered brokers and dealers, trust companies, and others who meet certain qualifications, and who pay certain annual fees, are entitled to become "participants" in CDS. Where a broker or dealer is a "participant" in CDS, it deposits the securities which it holds for its clients into CDS. As a result, those securities become, as a technical matter, registered in the name of CDS in the books of the issuers of those securities. In Canada, today, typically at least 95% of any publicly traded corporation's issued shares will be registered in the name of CDS. Many new issuers issue their securities now only in "book entry only" form.
4. To illustrate how this process works, let's take the example of an individual, Mr. Smith, who wants to buy and sell securities for his own account. If Mr. Smith is a typical retail investor, the first thing that he will do is to decide on a broker or investment dealer who will handle his business on an ongoing basis. If Mr. Smith wants to be an active investor, he may well choose to open an account with a "discount brokerage" firm which offers securities trading services at attractive prices. If Mr. Smith wishes to open an account, for example, with TD Waterhouse, he will complete a set of account forms which, among other things, will authorize TD Waterhouse to hold Mr. Smith's securities on his behalf. When Mr. Smith wishes to purchase common shares, for example, he will place his order through TD Waterhouse, who will act as his broker in purchasing the shares, typically through the facilities of The Toronto Stock Exchange, and will charge a fee or commission for that purpose. When the trade settles (3 days after purchase), TD Waterhouse will credit those shares to Mr. Smith's account and will direct CDS to credit those shares to TD Waterhouse's participant account in CDS. The registrar and transfer agent for the issuer of those shares will then receive information from CDS to the effect that CDS has become the registered owner of those shares. In these circumstances, it is helpful to think of the following:

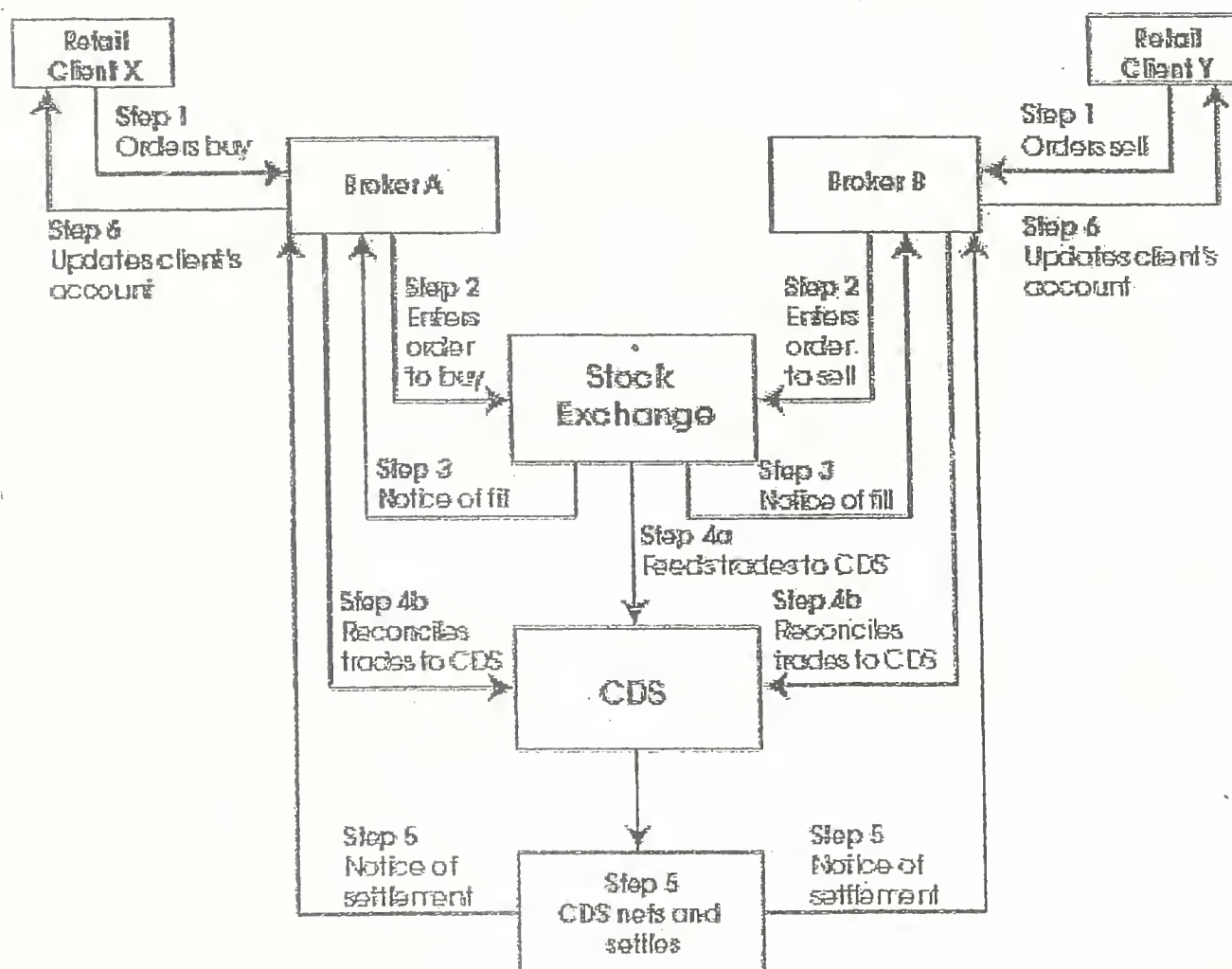
Registered Owners of Shares = CDS

"Participant" or "intermediary" = TD Waterhouse

Beneficial owner = Mr. Smith

5. The following further illustrates how the trade in shares for Mr. Smith (Client X, as shown below) would occur, including how the trades will "settle":

Retail Exchange Trade for Equities



Step 1: Client X orders Broker/Dealer A to buy stocks and Broker/Dealer B agrees to sell Client Y's shares

Step 2: Broker/Dealers A and B execute the trade by entering the order on an exchange

Step 3: The stock exchange sends a "fill" of the trade to Broker/Dealers A and B

Step 4: Broker/Dealers A and B and the stock exchange send details to The Canadian Depository for Securities Limited ("CDS"), Canada's national securities depository and clearing and settlement hub

Step 5: On T+3, CDS transfers cash and securities positions between the accounts of, and notifies, Broker/Dealers A and B

Step 6: Broker/Dealers A and B report the final transaction and update the accounts of their respective clients for funds and securities.

6. An important related piece of information which stems from the ownership chain described above is that, if Mr. Smith wishes to sell or dispose of his shares, i.e. including if a take-over bid is made for those shares and Mr. Smith wishes to tender his shares, he must do so through TD Waterhouse, which, in turn, must instruct CDS to take any necessary steps.
7. Some securities are not “eligible” to be held by CDS. Similarly, some brokers do not choose, for business reasons, to become “participants” of CDS. In the latter case, if Mr. Smith were to choose a broker who is not a CDS participant, it would be expected that Mr. Smith’s broker would hold shares in an account for him, and instruct the issuer’s registrar and transfer agent to register those shares in that broker’s name. In this case, the broker would become the registered shareholder, while Mr. Smith, again, would be the beneficial owner.

C. Institutional Investors

1. Institutional investors are very significant buyers and sellers of securities. Given the volume of securities with which they deal, and the variety of brokers and dealers with whom they may deal from time to time, it is typical for institutional investors to retain agents to act as safekeepers, or custodians, of their securities. In Canada, custodians are often trust companies and virtually all are participants in CDS. Accordingly, when an institutional investor buys or sells securities, while that investor will use the services of a broker or dealer to trade the securities, the securities will be directed to be held in the special account established for the client by its custodian. In this case, the registrar and transfer agent of the issuers of those securities purchased and held by the institutional investor will show CDS as the registered owner of those securities and CDS, in turn, will show the securities as held in the custodian’s account.
2. As might be expected, a custodianship agreement is typically extremely detailed with respect, in particular, to the manner in which the institutional investor may exercise its ownership rights over the securities. Institutional investors can, in virtually all circumstances, require their custodians to take whatever steps may be necessary in order to allow the institutional investor to exercise its rights with respect to those securities.

